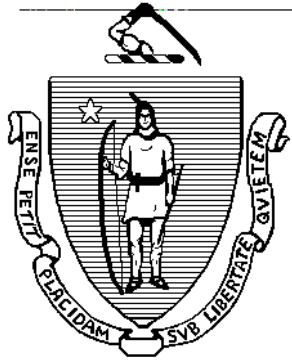
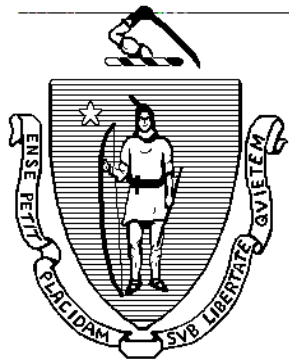


Financial Section



Independent Auditor's Report
Combined Financial Statements - Statutory Basis
Combining and Individual Fund Financial Statements - Statutory Basis



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**Independent Auditors' Report**

Mr. William Kilmartin, Comptroller
The Commonwealth of Massachusetts

We have audited the accompanying combined financial statements - statutory basis of the Commonwealth of Massachusetts as of June 30, 1997, and for the year then ended, listed in the foregoing table of contents. These combined financial statements - statutory basis are the responsibility of the management of the Commonwealth of Massachusetts. Our responsibility is to express an opinion on these combined financial statements - statutory basis based on our audit. We did not audit the financial statements of the Pension Reserves Investment Trust, which is the investment vehicle of the Commonwealth of Massachusetts' Pension Trust Funds, the financial statements of which reflect 86 percent and 46 percent, respectively, of the total assets and total revenues of the Fiduciary Fund Type. We did not audit the operations of the Massachusetts State Teachers' and Employees' Retirement Systems Trust, the financial operations of which reflect 10 percent of the revenues of the Fiduciary Fund Type, for the period from July 1, 1996 through the date of its merger with the Pension Reserves Investment Trust on December 31, 1996. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the entities not audited by us included in the Fiduciary Fund Type referred to above, is based solely on the reports of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements - statutory basis are free of material misstatement. The financial statements of the Pension Reserves Investment Trust and the Massachusetts State Teachers' and Employees' Retirement Systems Trust were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements - statutory basis. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement - statutory basis presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our opinion.

As described in Note 2 to the combined financial statements - statutory basis, the Commonwealth of Massachusetts prepares its combined financial statements - statutory basis on a prescribed basis of accounting that demonstrates compliance with General Laws and budgetary principles and funds of the Commonwealth of Massachusetts which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, based upon our audit and the reports of the other auditors, such combined financial statements - statutory basis referred to above present fairly, in all material respects, the financial position of the Commonwealth of Massachusetts as of June 30, 1997, and the results of its operations for the year then ended, on the basis of accounting described in Note 2.

As discussed in Note 14 to the combined financial statements - statutory basis, the Commonwealth of Massachusetts has changed its reporting requirements for the combined financial statements - statutory basis.

Our audit was conducted for the purpose of forming an opinion on the combined financial statements - statutory basis taken as a whole. The combining and individual fund statements - statutory basis, and required supplemental information listed in the table of contents, are presented for the purpose of additional analysis and are not a required part of the combined financial statements - statutory basis of the Commonwealth of Massachusetts. These statements, schedules and required supplemental information are also the responsibility of the management of the Commonwealth of Massachusetts. Such additional information has been subjected to the auditing procedures applied in the audit of the combined financial statements - statutory basis and, based on our audit and the reports of other auditors, in our opinion, is fairly stated in all material respects in relation to the combined financial statements - statutory basis taken as a whole.

We did not audit the data included in the introductory and statistical sections of this report and accordingly, we express no opinion on such data.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 31, 1997 on our consideration of the Commonwealth of Massachusetts internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

This report is intended solely for the use of elected and appointed officials of the Commonwealth of Massachusetts and should not be used for any other purposes. This report is a matter of public record and its distribution is not limited.

October 31, 1997

Combined Financial Statements -Statutory Basis

All Fund Types And Account Groups
Combined Balance Sheet - Statutory Basis

June 30, 1997
(Amounts in thousands)

	Governmental Fund Types			Fiduciary Fund Types
	Budgeted	Non-budgeted Special Revenue	Capital Projects	Trust and Agency
ASSETS AND OTHER DEBITS				
Cash and short-term investments.....	\$ 2,371,364	\$ 180,050	\$ 249,818	\$ 1,229,252
Cash on deposit with U.S. Treasury.....	-	-	-	1,222,725
Cash with fiscal agent.....	24,823	-	-	-
Investments.....	-	-	-	19,528,772
Advances to related entity.....	229,063	-	-	-
Assets held in trust.....	-	-	-	1,708,422
Receivables, net of allowance for uncollectibles:				
Taxes.....	6,486	949	-	-
Due from federal government.....	371,546	137,705	165,528	-
Other receivables.....	52,776	2,282	-	218,393
Due from cities and towns.....	141,580	-	-	-
Due from other funds.....	3,657	-	-	-
Fixed assets:				
Land.....	-	-	-	-
Buildings.....	-	-	-	-
Machinery and equipment.....	-	-	-	-
Construction in progress.....	-	-	-	-
Amount to be provided for retirement of long-term obligations....	-	-	-	-
Total assets and other debits.....	<u>\$ 3,201,295</u>	<u>\$ 320,986</u>	<u>\$ 415,346</u>	<u>\$ 23,907,564</u>
LIABILITIES, FUND EQUITY AND OTHER CREDITS				
Liabilities:				
Deficiency in cash and short-term investments.....	\$ 1,206,082	\$ 19,479	\$ 215,644	\$ -
Accounts payable.....	585,985	145,037	331,239	520,792
Accrued payroll.....	15,182	592	240	34
Other liabilities.....	-	-	-	2,469,062
Due to cities and towns.....	-	-	-	20,142
Due to federal government.....	-	-	-	-
Due to other funds.....	-	-	-	3,657
Capital leases.....	-	-	-	-
Bonds and notes payable.....	-	-	-	-
Total liabilities.....	<u>1,807,249</u>	<u>165,108</u>	<u>547,123</u>	<u>3,013,687</u>
Fund equity and other credits:				
Investment in general fixed assets.....	-	-	-	-
Fund balances (deficit):				
Reserved for:				
Continuing appropriations.....	180,260	-	-	-
Commonwealth stabilization.....	799,300	-	-	-
Tax reduction fund-current	91,764	-	-	-
Tax reduction fund-future.....	-	-	-	-
Debt service.....	44,891	-	-	-
Employees' pension benefits.....	-	-	-	19,560,061
Unemployment benefits.....	-	-	-	1,222,725
Capital projects.....	-	-	229,800	-
Unreserved:				
Designated for specific purpose.....	-	155,878	-	111,091
Undesignated.....	277,831	-	(361,577)	-
Total fund equity (deficit) and other credits.....	<u>1,394,046</u>	<u>155,878</u>	<u>(131,777)</u>	<u>20,893,877</u>
Total liabilities, fund equity and other credits.....	<u>\$ 3,201,295</u>	<u>\$ 320,986</u>	<u>\$ 415,346</u>	<u>\$ 23,907,564</u>

See notes to combined financial statements - statutory basis.

Account Groups		Totals (Memorandum Only)	
General Fixed Assets	General Long-term Obligations	1997	1996
\$ -	\$ -	\$ 4,030,484	\$ 2,897,318
-	-	1,222,725	761,987
-	-	24,823	22,571
-	-	19,528,772	16,205,800
-	-	229,063	227,512
-	-	1,708,422	1,648,336
-	-	7,435	3,715
-	-	674,779	467,831
-	-	273,451	189,534
-	-	141,580	138,766
-	-	3,657	7,901
564,854	-	564,854	534,160
3,700,765	-	3,700,765	3,867,046
1,177,749	-	1,177,749	978,158
121,370	-	121,370	43,334
-	10,402,669	10,402,669	10,167,746
<u>\$ 5,564,738</u>	<u>\$ 10,402,669</u>	<u>\$ 43,812,598</u>	<u>\$ 38,161,715</u>
\$ -	\$ -	\$ 1,441,205	\$ 666,528
-	-	1,583,053	1,297,336
-	-	16,048	42,527
-	-	2,469,062	2,344,033
-	-	20,142	18,147
-	-	-	51
-	-	3,657	7,901
-	131,375	131,375	102,168
-	10,271,294	10,271,294	10,305,578
-	10,402,669	15,935,836	14,784,269
5,564,738	-	5,564,738	5,422,698
-	-	180,260	240,773
-	-	799,300	543,303
-	-	91,764	150,000
-	-	-	81,722
-	-	44,891	22,571
-	-	19,560,061	15,956,271
-	-	1,222,725	761,987
-	-	229,800	-
-	-	266,969	281,056
-	-	(83,746)	(82,935)
5,564,738	-	27,876,762	23,377,446
<u>\$ 5,564,738</u>	<u>\$ 10,402,669</u>	<u>\$ 43,812,598</u>	<u>\$ 38,161,715</u>

All Governmental Fund Types And Expendable Trust Funds
Combined Statement Of Revenues, Expenditures And Changes In Fund Balances - Statutory Basis

Fiscal Year Ended June 30, 1997
(Amounts in thousands)

	Governmental Fund Types		
	Budgeted	Non-budgeted Special Revenue	Capital Projects
REVENUES AND OTHER FINANCING SOURCES			
Revenues:			
Taxes.....	\$ 12,864,501	\$ 9,918	\$ -
Assessments.....	226,070	330,723	-
Federal grants and reimbursements.....	3,019,692	1,213,554	1,035,630
Departmental.....	1,107,736	3,442,527	353
Miscellaneous.....	169,223	32,735	1,736
Total revenues.....	17,387,222	5,029,457	1,037,719
Other financing sources:			
Proceeds of general obligation bonds.....	-	-	899,471
Proceeds of special obligation bonds.....	-	-	-
Proceeds of refunding bonds.....	-	-	722,621
Fringe benefit cost recovery.....	197,667	-	-
Lottery reimbursements.....	76,486	5,024	-
Lottery distributions.....	685,137	-	-
Transfer for MBTA contract assistance.....	137,869	-	-
Sewer rate relief.....	-	54,398	-
Caseload mitigation.....	128,000	-	-
Surplus transfer to capital projects.....	-	-	89,503
Capital investment trust fund transfer.....	-	-	229,800
Operating transfers in.....	176,732	28,078	-
Collective bargaining reserve.....	50,000	-	-
Stabilization transfer.....	234,253	-	-
Transfer for tax reduction.....	150,000	-	-
State share of federal highway construction.....	-	-	175,958
Other sources.....	-	-	-
Total other financing sources.....	1,836,144	87,500	2,117,353
Total revenues and other financing sources.....	19,223,366	5,116,957	3,155,072
EXPENDITURE AND OTHER FINANCING USES			
Expenditures:			
Legislature.....	48,968	-	1,643
Judiciary.....	426,054	2,121	9,176
Inspector General.....	1,602	-	728
Governor and Lieutenant Governor.....	5,263	-	-
Secretary of the Commonwealth.....	16,358	780	1,352
Treasurer and Receiver-General.....	96,590	2,583,437	21,337
Auditor of the Commonwealth.....	12,766	-	600
Attorney General.....	23,531	3,071	1,694
Ethics Commission.....	1,193	-	-
District Attorney.....	60,335	931	31
Office of Campaign & Political Finance.....	670	-	-
Disabled Persons Protection Commission.....	1,429	47	-
Board of Library Commissioners.....	3,862	2,495	14,395
Comptroller.....	6,730	-	1,756
Administration and finance.....	992,637	66,361	235,607
Environmental affairs.....	178,577	23,381	107,020
Health and human services.....	3,577,268	657,246	39,150
Transportation and construction.....	794,087	12,486	1,657,581
Education.....	179,540	389,569	19,494
Educational affairs.....	-	-	-
Higher education.....	806,470	4,358	6,767
Public safety.....	827,995	28,455	23,724
Economic development.....	163,890	225,943	71,057
Elder affairs.....	140,834	25,982	93

Fiduciary Fund Type	Totals (Memorandum Only)	
	1997	1996
Expendable Trust		
\$ 1,174,332	\$ 14,048,751	\$ 13,189,317
1,686	558,479	558,852
29,701	5,298,577	5,166,947
6,724	4,557,340	4,486,962
214,808	418,502	464,657
1,427,251	24,881,649	23,866,735
-	899,471	939,658
-	-	147,457
-	722,621	-
-	197,667	216,887
-	81,510	76,558
-	685,137	651,496
-	137,869	157,523
-	54,398	23,200
-	128,000	-
-	89,503	-
-	229,800	-
6,971	211,781	424,489
-	50,000	60,000
-	234,253	177,405
-	150,000	231,722
-	175,958	132,423
2,073	2,073	2,155
9,044	4,050,041	3,240,973
1,436,295	28,931,690	27,107,708
-	50,611	48,889
229	437,580	405,530
-	2,330	1,875
-	5,263	4,682
5	18,495	17,251
7,033	2,708,397	2,591,407
285	13,651	12,614
1,724	30,020	27,082
-	1,193	1,139
3,215	64,512	58,743
-	670	652
-	1,476	1,395
-	20,752	14,903
-	8,486	9,079
5,320	1,299,925	1,140,948
7,613	316,591	333,479
18,299	4,291,963	4,345,850
2,609	2,466,763	2,232,468
1,140	589,743	525,672
-	-	13,696
103	817,698	763,545
2,967	883,141	865,286
2,732	463,622	534,208
50	166,959	162,180

All Governmental Fund Types And Expendable Trust Funds
Combined Statement Of Revenues, Expenditures And Changes In Fund Balances - Statutory Basis

Fiscal Year Ended June 30, 1997
(Amounts in thousands)

	Governmental Fund Types		
	Budgeted	Non-budgeted Special Revenue	Capital Projects
Expenditures (continued):			
Consumer affairs.....	35,367	1,586	43
Labor.....	38,213	154,856	-
Direct local aid.....	3,558,139	6,514	-
Medicaid.....	3,455,531	-	-
Pension.....	1,069,184	-	-
Debt service:			
Principal retirement.....	750,459	2,210	-
Interest and fiscal charges.....	525,080	537	-
Total expenditures.....	17,798,622	4,192,366	2,213,248
Other financing uses:			
Payments to refunded bond escrow agent.....	-	-	722,621
Fringe benefit cost assessment.....	63,017	42,617	16,990
Lottery operating reimbursements.....	-	81,510	-
Lottery distributions.....	-	685,137	-
Transfer for MBTA contract assistance.....	137,869	-	-
State share of federal highway construction.....	-	59,753	116,205
Operating transfers out.....	66,866	77,804	211
Sewer rate relief.....	54,398	-	-
Collective bargaining reserve.....	50,000	-	-
Caseload mitigation.....	128,000	-	-
Capital investment trust fund transfer.....	229,800	-	-
Surplus transfer for capital projects.....	89,503	-	-
Stabilization transfer.....	234,253	-	-
Transfer for tax reduction.....	150,000	-	-
Total other financing uses.....	1,203,706	946,821	856,027
Total expenditures and other financing uses.....	19,002,328	5,139,187	3,069,275
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses.....	221,038	(22,230)	85,797
Fund balances (deficits) at beginning of year.....	1,173,008	178,108	(217,574)
Fund balances (deficits) at end of year.....	\$ 1,394,046	\$ 155,878	\$ (131,777)

See notes to combined financial statements - statutory basis.

Fiduciary Fund Type	Totals (Memorandum Only)	
Expendable Trust	1997	1996
7,098	44,094	41,805
837,727	1,030,796	968,918
-	3,564,653	3,251,965
-	3,455,531	3,415,949
-	1,069,184	1,004,551
-	752,669	684,266
-	525,617	507,515
898,149	25,102,385	23,987,542
-	722,621	-
2,365	124,989	139,164
-	81,510	76,558
-	685,137	651,496
-	137,869	157,523
-	175,958	132,423
66,900	211,781	424,489
-	54,398	23,200
-	50,000	60,000
-	128,000	-
-	229,800	-
-	89,503	-
-	234,253	177,405
-	150,000	231,722
69,265	3,075,819	2,073,980
967,414	28,178,204	26,061,522
468,881	753,486	1,046,186
859,100	1,992,642	946,456
\$ 1,327,981	\$ 2,746,128	\$ 1,992,642

Budgeted Funds

Combined Statement Of Revenues, Expenditures And Changes In Fund Balances - Statutory Basis - Budget and Actual

Fiscal Year Ended June 30, 1997
(Amounts in thousands)

	Budget	Actual	Variance Favorable (Unfavorable)
REVENUES AND OTHER FINANCING SOURCES			
Revenues:			
Taxes.....	\$ 12,188,000	\$ 12,864,501	\$ 676,501
Assessments.....	-	226,070	226,070
Federal grants and reimbursements.....	2,974,900	3,019,692	44,792
Departmental.....	1,271,100	1,107,736	(163,364)
Miscellaneous.....	-	169,223	169,223
Total revenues.....	16,434,000	17,387,222	953,222
Other financing sources:			
Fringe benefit cost recovery.....	-	197,667	197,667
Lottery reimbursements.....	86,539	76,486	(10,053)
Lottery distributions.....	631,543	685,137	53,594
Transfer for MBTA contract assistance.....	-	137,869	137,869
Caseload mitigation.....	-	128,000	128,000
Operating transfers in.....	212,018	176,732	(35,286)
Collective bargaining reserve.....	-	50,000	50,000
Stabilization transfer.....	-	234,253	234,253
Transfer for tax reduction.....	-	150,000	150,000
Total other financing sources.....	930,100	1,836,144	906,044
Total revenues and other financing sources.....	17,364,100	19,223,366	1,859,266
EXPENDITURE AND OTHER FINANCING USES			
Expenditures:			
Legislature.....	70,895	48,968	21,927
Judiciary.....	438,291	426,054	12,237
Inspector General.....	1,612	1,602	10
Governor and Lieutenant Governor.....	6,364	5,263	1,101
Secretary of the Commonwealth.....	17,166	16,358	808
Treasurer and Receiver-General.....	105,470	96,590	8,880
Auditor of the Commonwealth.....	12,770	12,766	4
Attorney General.....	23,825	23,531	294
Ethics Commission.....	1,193	1,193	-
District Attorney.....	60,959	60,335	624
Office of Campaign & Political Finance.....	671	670	1
Disabled Persons Protection Commission.....	1,434	1,429	5
Board of Library Commissioners.....	3,874	3,862	12
Comptroller.....	6,763	6,730	33
Administration and finance.....	1,153,308	992,637	160,671
Environmental affairs.....	197,273	178,577	18,696
Health and human services.....	3,694,642	3,577,268	117,374
Transportation and construction.....	797,186	794,087	3,099
Education.....	184,708	179,540	5,168
Higher education.....	812,886	806,470	6,416
Public safety.....	847,634	827,995	19,639
Economic development.....	172,180	163,890	8,290
Elder affairs.....	141,830	140,834	996
Consumer affairs.....	37,303	35,367	1,936
Labor.....	42,533	38,213	4,320
Direct local aid.....	3,566,896	3,558,139	8,757
Medicaid.....	3,517,736	3,455,531	62,205
Pension.....	1,075,560	1,069,184	6,376
Debt service:			
Principal retirement.....	777,895	750,459	27,436
Interest and fiscal charges.....	542,595	525,080	17,515
Total expenditures.....	18,313,452	17,798,622	514,830
Other financing uses:			
Fringe benefit cost assessment.....	-	63,017	(63,017)
Transfer for MBTA contract assistance.....	137,869	137,869	-
Operating transfers out.....	66,866	66,866	-
Sewer rate relief.....	54,398	54,398	-
Collective bargaining reserve.....	50,000	50,000	-
Caseload mitigation.....	128,000	128,000	-
Capital investment trust fund transfer.....	229,800	229,800	-
Surplus transfer for capital projects.....	-	89,503	(89,503)
Stabilization transfer.....	100,000	234,253	(134,253)
Transfer for tax reduction.....	150,000	150,000	-
Total other financing uses.....	916,933	1,203,706	(286,773)
Total expenditures and other financing uses.....	19,230,385	19,002,328	228,057
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses.....	(1,866,285)	221,038	2,087,323
Fund balances at beginning of year.....	1,173,008	1,173,008	-
Fund balances (deficits) at end of year.....	\$ (693,277)	\$ 1,394,046	\$ 2,087,323

See notes to combined financial statements - statutory basis.

Nonexpendable Trust Fund

Statement Of Revenues, Expenses And Changes In Fund Balances - Statutory Basis

Fiscal Year Ended June 30, 1997
(Amounts in thousands)

	1997	1996
Operating revenues:		
Investment earnings.....	\$ -	\$ -
Total operating revenues.....	-	-
Operating expenses:		
Administration.....	-	2
Total operating expenses.....	-	2
Net income (deficit).....	-	(2)
Fund balances at beginning of year.....	5,835	5,837
Fund balances at end of year.....	\$ 5,835	\$ 5,835

See notes to combined financial statements - statutory basis.

Pension Trust Funds

Combined Statement of Changes in Net Assets Available for Pension Benefits - Statutory Basis

Fiscal Year Ended June 30, 1997
(Amounts in thousands)

	1997	1996
Additions:		
Commonwealth contributions.....	\$ 899,048	\$ 850,841
Employees contributions.....	457,530	449,210
Total contributions.....	<u>1,356,578</u>	<u>1,300,051</u>
Net investment income:		
Net appreciation in fair value of investments.....	2,823,841	1,786,940
Interest.....	368,654	363,645
Dividends.....	158,922	125,716
Real estate operating income, net.....	54,525	37,929
Alternative investments.....	27,457	14,943
Other.....	156	2,915
Total investment income.....	<u>3,433,555</u>	<u>2,332,088</u>
Less: investment expense.....	60,703	43,406
Net investment income.....	<u>3,372,852</u>	<u>2,288,682</u>
Total additions.....	<u>4,729,430</u>	<u>3,588,733</u>
Deductions:		
Administration.....	3,688	3,673
Retirement benefits and refunds.....	1,121,952	1,083,898
Total deductions.....	<u>1,125,640</u>	<u>1,087,571</u>
Net increase	3,603,790	2,501,162
Net assets available for pension benefits at beginning of year (fund balances reserved for employees' pension benefits).....	<u>15,956,271</u>	<u>13,455,109</u>
Net assets available for pension benefits at end of year (fund balances reserved for employees' pension benefits).....	<u>\$ 19,560,061</u>	<u>\$ 15,956,271</u>

See notes to combined financial statements - statutory basis.

1. FINANCIAL STATEMENT PRESENTATION

Introduction – The accompanying combined financial statements – statutory basis of the Commonwealth of Massachusetts (the Commonwealth) are presented in accordance with the requirements of Section 12 of Chapter 7A, as amended by Section 4 of Chapter 88 of the Acts of 1997 of the Massachusetts General Laws. The Office of the Comptroller also publishes the Commonwealth's Comprehensive Annual Financial Report (CAFR) which is prepared on the basis of generally accepted accounting principles (GAAP) for governments as prescribed by the Governmental Accounting Standards Board, the authoritative standard-setting body for establishing governmental accounting and financial reporting principles.

The combined financial statements – statutory basis include all budgeted and non-budgeted funds and account groups of the Commonwealth, as recorded by the Office of the Comptroller in compliance with Massachusetts General Laws and in accordance with the Commonwealth's budgetary principles.

The combined financial statements – statutory basis are not intended to include independent authorities, Non-appropriated Funds of higher education or other organizations included in the Commonwealth's reporting entity as it would be defined under GAAP.

Statutory Basis Accounting – The Commonwealth reports its statutory basis financial position and results of operations in funds and account groups, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

Account groups are accounting entities used to provide accountability for the Commonwealth's general fixed assets and long-term obligations. They are not considered funds because they do not report expendable available financial resources and related liabilities.

The Fund types and account groups are organized as follows:

Governmental Fund Types - accounts for the general governmental activities of the Commonwealth.

Budgeted Funds – are the primary operating funds of the Commonwealth. They account for all budgeted governmental transactions. Major budgeted funds include the General, Highway and Local Aid funds which are identified by the Comptroller as the operating funds of the Commonwealth.

Non-Budgeted Special Revenue Funds – are established by law to account for specific revenue sources that have been segregated from the budgeted funds to support specific governmental activities such as federal grants and the operations of the state lottery.

Capital Projects Funds – account for financial resources used to acquire or construct major capital assets and to finance local capital projects. These resources are derived from proceeds of general obligation bonds and operating transfers authorized by the Legislature, which are generally received after the expenditure has been incurred, and from federal reimbursements. Deficit balances in Capital Projects Funds represent amounts to be financed.

Fiduciary Fund Types – account for assets held by the Commonwealth in a trustee capacity (Trust Funds), or as an agent (Agency Funds) for individuals, private organizations, other governmental units, and/or other funds.

Expendable Trust Funds – account for trusts whose principal and investment income may be expended for their designated purpose.

Nonexpendable Trust Funds – account for trusts whose principal cannot be spent.

Pension Trust Funds – account for the net assets available for plan benefits held in trust for the State Employees' and Teachers' Retirement Systems.

Agency Funds – account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

Account Groups – establish control and accountability over the Commonwealth's general fixed assets and long-term obligations.

General Fixed Assets Account Group – accounts for the general fixed assets of the Commonwealth.

General Long-term Obligations Account Group – accounts for long-term bonds and notes issued by the

Commonwealth, capital leases, and certificates of participation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statutory Basis of Accounting – The Statutory Basis Financial Report is prepared from the Commonwealth's books and records and other official reports which are maintained on the basis of accounting used in the preparation of the Commonwealth's legally adopted annual budget (statutory basis). The statutory basis emphasizes accountability and budgetary control of appropriations. The Statutory Basis Financial Report is not intended to present the Commonwealth's financial condition and results of operations in conformity with GAAP.

Revenues are generally recognized when cash deposits are received by Treasury. However, revenues receivable for federal grants and reimbursements are recognized when related expenditures are incurred. Amounts due from political subdivisions of the Commonwealth are recognized when considered measurable and available. Deeds excise taxes are recognized at the time of collection by the counties.

Expenditures are generally recorded when the related cash disbursement occurs. At year end, payroll is accrued and payables are recognized, to the extent of approved encumbrances, for goods or services received by June 30. Costs incurred under the federally-sponsored Medicaid program, amounts required to settle claims and judgments against the Commonwealth, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment.

The Pension Trust Funds are reported using a flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. This measurement focus emphasizes the determination of net income.

The accounting policies followed in preparing the accompanying combined financial statements – statutory basis are described as follows.

Cash and Short-term Investments and Investments –

The Commonwealth follows the practice of pooling the cash and cash equivalents of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost. Interest earned on pooled cash

is allocated to the General Fund, Expendable Trust Funds and to certain Special Revenue Funds when so directed by law.

The Pension Trust Funds, with investments totaling \$18,969,226,000, at fair value, are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The Pension Trust Funds include investments in real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leverage buyouts, private placements and other alternative investments. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentration of credit risk exists if a number of companies in which the fund has invested are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 1997, the estimated fair values, determined by management with input from the investment managers, of these real estate and alternative investments were \$1,539,701,000 the Pension Trust Funds, representing .8% of the total assets of the Fiduciary Fund Type.

Securities Lending Program - The Pension Trust Funds participate in securities lending programs. Under these programs, the Trusts receive a fee for allowing brokerage firms to borrow certain securities for a predetermined period of time, securing such loans with cash or collateral typically equaling 102% to 105% of the fair value of the security borrowed. At June 30, 1997, the market value of the securities on loan from the Pension Reserve Investment Trust (PRIT) was approximately \$1,026,000,000. The value of the collateral held by PRIT amounted to \$1,057,000,000 at June 30, 1997. The PRIT securities on loan were collateralized at all times by US Treasury securities of at least 100% of the value.

Receivables – Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the Commonwealth for its expenditures on federally-funded reimbursement and grant programs are reported as "Due from federal government."

Advances to Related Entity – The Commonwealth periodically provides working capital advances to the

Massachusetts Bay Transportation Authority (MBTA) to fund its net cost of service. A portion of these advances is financed by sales of short-term notes which are repaid through subsequent appropriations by the Legislature and assessments to cities and towns for their respective shares of the MBTA's net cost of service.

Inventories – The costs of materials and supplies are recorded as expenditures in Governmental Funds when purchased. Such inventories are not material in total to the financial statements and therefore are not recorded.

General Fixed Assets – General fixed asset acquisitions are recorded as expenditures in the acquiring fund and capitalized in the General Fixed Assets Account Group in the year purchased. General fixed assets are recorded at historical cost, or at estimated historical cost if actual historical cost is not available. Donated fixed assets are recorded at estimated fair market value at the date of donation.

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Improvements are capitalized.

The Commonwealth capitalizes all land. It capitalizes buildings and equipment, including computer software, with costs in excess of fifteen thousand dollars at the date of acquisition and with expected useful lives greater than one year. Interest incurred during construction is not material and is not capitalized. Public domain general fixed assets and infrastructure (roads, bridges, tunnels, dams, water and sewer systems, etc.) are not capitalized. No depreciation is provided on general fixed assets.

Interfund/Intrafund Transactions – During the course of its operations, the Commonwealth records transactions between funds and/or between departments. On the statutory basis, transactions between Governmental and Fiduciary Fund Types are recorded as adjustments to the funds' cash accounts. As a result, a fund may report a deficiency in cash and short-term investments.

Transactions of a buyer/seller nature between departments within a fund are not eliminated.

Risk Financing – The Commonwealth does not insure for employees workers' compensation, casualty, theft, tort claims and other losses. Such liabilities are not recognized on the statutory basis until encumbered and/or processed for payment. For employees workers' compensation, the Commonwealth assumes the full risk of claims filed under a program managed in FY97 by the

Public Employee Retirement Administration Commission. For personal injury or property damages, Chapter 258 of the Massachusetts General Laws (General Laws) limits the risk assumed by the Commonwealth to \$100,000 per occurrence, in most circumstances. The Group Insurance Commission administers contributory health care and other insurance programs for the Commonwealth's employees and retirees.

The Commonwealth has entered into agreements for insurance for Central Artery/Third Harbor Tunnel Project workers' compensation and certain other claims that may arise in the course of the Project. This special arrangement has been approved by the Federal Highway Administration as a cost-effective method to fund current and potential future claims by contractors, workers, and other parties affected by the project. Pursuant to the agreement, the Commonwealth conveys a sum of money to the agent each month. This amount includes both federal and state share. The agent manages and settles all claims. At the conclusion of the program, the balance remaining, if any, will be returned to the Commonwealth and the federal government. The monthly amount conveyed to the agent is accounted for (on the statutory basis of accounting) as an expenditure in the Federal Highway Capital Projects Fund.

Encumbrances – Encumbrance accounting is utilized in the Governmental Fund Types as a significant aspect of budgetary control. The full amounts of purchase orders, contracts and other commitments of appropriated resources are encumbered and recorded as deductions from appropriations prior to actual expenditure, ensuring that such commitments do not exceed appropriations. Encumbrances outstanding at year end for goods or services received on or before June 30 are reported as statutory basis liabilities and expenditures; excess encumbrances are lapsed.

Fringe Benefit Cost Recovery – The Commonwealth appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund and the Intragovernmental Service Fund. These fringe benefits include the costs of employees' health insurance, pensions, unemployment compensation, and other costs necessary to support the state work force. As directed by Chapter 29, Sections 5D and 6B(f) of the Massachusetts General Laws, these costs are assessed to other funds based on their payroll costs, net of credits for direct payments. Since these fringe benefit costs are not appropriated in the budget, the required assessment creates a variance between budget and actual expenditures at year end. The fringe benefit cost

recoveries of \$197,667,000 in the budgeted funds are offset by fringe benefit costs assessments of \$124,989,000 in the governmental fund types and the expendable trust funds. In addition, \$72,678,000 is assessed against the higher education non-appropriated activity which is not included in the combined financial statements - statutory basis.

Compensated Absences – Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements and state laws. Upon retirement, termination or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their then-current rate of pay. Vacation and sick leave are recorded as expenditures when paid.

Fund Balances – The Commonwealth reports fund balances as reserved where legally restricted for a specific future use. Otherwise, these balances are considered unreserved.

Fund balance has been reserved as follows:

“Reserved for continuing appropriations” – identifies unexpended amounts in appropriations which the Legislature has specifically authorized to be carried into the next fiscal year.

“Reserved for Commonwealth stabilization” – identifies amounts set aside in the Commonwealth Stabilization Fund according to Section 5 and 5C of Chapter 29.

“Reserved for tax reduction fund - current and future” - identifies the amount set aside according to Section 6 of Chapter 29B of the Massachusetts General Laws. The amount can only be used to reduce personal income taxes as provided in the Chapter.

“Reserved for debt service” – identifies amounts held by fiscal agents to fund future debt service obligations pertaining to the Commonwealth Fiscal Recovery Loan Act of 1990, and to Special Obligation Revenue Bonds authorized under Section 20 of Chapter 29 of the Massachusetts General Laws and Chapter 33, Acts of 1991.

“Reserved for employees’ pension benefits” – identifies the net assets of the Commonwealth’s public employee retirement systems which cannot be used for any other purpose.

“Reserved for unemployment benefits” – identifies amounts reserved for payment of unemployment

compensation.

“Reserved for capital projects” - identifies amounts reserved for capital projects.

Unreserved fund balance is segregated into two components:

“Designated for specific purpose” – identifies all unreserved fund balances for which the Legislature or Executive Branch has evidenced an intention to restrict for a specific purpose.

“Undesignated” – consists of cumulative surpluses or deficits of the Governmental Fund Types not otherwise designated.

Reclassification – Certain reclassifications have been made to the 1996 account balances to conform to the presentation used in 1997.

In instances where reorganization resulted in departments changing secretariats in 1997, prior year numbers have been restated. Changes in individual programs or items of appropriation have not been restated.

3. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts an expenditure budget by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriations acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account’s expenditure budget.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds which effectively reduce the account's expenditure budget.

The majority of the Commonwealth's appropriations are non-continuing accounts which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislature may direct that certain revenues be retained and made available for spending within an appropriation to allocate fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

The original fiscal year 1997 appropriations act was Chapter 151, Acts of 1996. This appropriation act authorized \$16,664,007,000 in direct appropriations. In addition, the act continued \$814,203,000 in authorizations to retain and expend certain non-tax revenues of which \$783,274,000 was estimated to be collected and expended, plus \$99,230,000 of interagency chargebacks. Chapter 151 included estimates of \$12,188,000,000 in tax revenues and approximately \$5,152,000,000 in non-tax revenues. With these revenues (exclusive of chargebacks) projected to total approximately \$17,340,000,000 and with unreserved balances of approximately \$134,044,000 carried forward from the fiscal year 1996, the budget as presented in this original appropriation act was considered to be in balance.

During fiscal year 1997, the Legislature also passed and the Governor signed, with some modification through veto, Chapters 204, 365, 414, 435 of the Acts of 1996, and Chapters 1, 10, and 36 of the Acts of 1997, which included numerous supplemental budgetary appropriations. These supplements added \$136,808,000 in direct appropriations and \$2,445,000 in additional retained revenue authorizations.

Subsequent to June 30, 1997 the Legislature passed and the Governor signed Chapters 43, 48, and 88 of the Acts of 1997 which included \$223,392,000 in additional supplemental appropriations \$20,260,000 in additional retained revenue authorizations and \$50,000 in additional interagency chargebacks. The cumulative fiscal year 1997 appropriations, retained revenues, and interagency

chargebacks totaled \$17,960,395,000. Appropriations continued from fiscal year 1996 totaled approximately \$240,773,000, and certain interfund transfers directed by statute totaled approximately \$1,029,216,000.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a discrepancy to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. In addition, certain interfund assessments to allocate fringe benefits and other costs which are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

The following table isolates this interfund activity from the budgeted sources and uses to align more clearly forecasts prepared during the budget process to the detailed fund accounting of the Commonwealth's statutory financial statements (amounts in thousands):

	Revenues and Other Financing Sources	Expenditures and Other Financing Uses
Actual as presented in the combined budget and actual statement - statutory basis.....	\$19,223,366	\$19,002,328
Adjustments to revenues and expenditures		
Municipal transit assessments.....	(151,525)	(151,525)
Transfer to the Intragovernmental Service Fund Revenues.....	(83,622)	(83,622)
Adjustments to other financing sources and uses:		
MBTA subsidy transfer.....	(137,869)	(137,869)
Fringe benefit cost assessments.....	(63,017)	(63,017)
Transfer from the Intragovernmental Service Fund to the General Fund.....	(2,402)	(2,402)
Transfer from the Revenue Maximization Fund to the General Fund.....	(50,245)	(50,245)
RMV License Plates.....	(2,274)	(2,274)
Caseload Mitigation Transfers.....	(128,000)	(128,000)
Stabilization transfers.....	(234,253)	(234,253)
Collective Bargaining Reserve.....	(50,000)	(50,000)
Transfer to Tax Reduction Fund.....	(150,000)	(150,000)
Miscellaneous.....	(107)	(107)
Actual as presented on budgetary documents	<u>\$18,170,052</u>	<u>\$17,949,014</u>

Following is a list of budgeted funds grouped by

categories:

Major Budgeted Funds: General Fund, Highway Fund, Infrastructure Fund (subfund of Highway Fund) and Local Aid Fund.

Other Budgeted Funds: Commonwealth Stabilization Fund.

Administrative Control Funds: Tax Reduction Fund, Intergovernmental Service Fund, Revenue Maximization Fund, Collective Bargaining Reserve Fund and Commonwealth Fiscal Recovery Fund.

Environmental Funds: Natural Heritage and Endangered Species Fund, Mosquito and Greenhead Fly Control Fund, Inland Fisheries and Game Fund, Environmental Challenge Fund, Toxics Use Reduction Fund, Clean Environment Fund, Environmental Permitting and Compliance Assurance Fund, Underground Storage Tank Petroleum Product Cleanup Fund, Environmental Law Enforcement Fund, Public Access Fund, Harbors and Inland Waters Maintenance Fund, Marine Fisheries Fund, Watershed Management Fund, Low Level Radioactive Waste Management Fund, Asbestos Cost Recovery Fund, Clean Air Act Compliance Fund, Solid Waste Disposal Fund, and Second Century Fund.

Other Budgeted Special Revenue Funds: Antitrust Law Enforcement Fund, Victim and Witness Assistance Fund, Intercity Bus Capital Assistance Fund, Motorcycle Safety Fund, Drug Analysis Fund, Re-Employment and Job Placement Fund, Trust Fund for the Head Injury Treatment Services, Massachusetts Tourism Fund, Health Care Access Fund, Ponkapoag Recreational Fund, Leo J. Martin Recreation Fund, Division of Insurance Fund, Health Protection Fund, State Building Management Fund, Reggie Lewis Track & Athletic Center Fund, Assisted Living Administration Fund, Commonwealth Cost Relief Fund, Children's & Senior's Health Fund, Diversity Awareness Education Trust Fund, Caseload Increase Mitigation Fund, Division of Banks Fund, and University of Massachusetts Lowell Wannalancit Complex Building Management Fund.

The Office of the Comptroller has the responsibility to ensure that budgetary control is maintained on an individual appropriation account basis. Budgetary control is exercised through the state accounting system, Massachusetts Management Accounting and Reporting System (MMARS). Encumbrances and expenditures are not allowed to exceed the appropriation account's spending authorization.

4. DEPOSITS AND INVESTMENTS

The Commonwealth maintains a cash and short-term investment pool that is available for use by all funds. Each fund type's net equity in this pool is displayed on the combined balance sheet as either "Cash and short-term investments" or "Deficiency in cash and short-term investments." The investments of the Pension Trust Funds are held and managed in separate and pooled trusts.

The Office of the Treasurer and Receiver-General (the "Treasury") manages the Commonwealth's short-term investment pool. Statutes authorize investment in obligations of the U.S. Treasury, authorized bonds of all states, banker's acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by Standard & Poor's Corporation and Moody's Commercial Paper Record and repurchase agreements that any of these obligations secure. Such investments are carried at cost, which approximates market.

The pooled cash and short-term investments at June 30, 1997 are as follows (amounts in thousands):

	Carrying Value
Cash.....	\$ 22,092
Certificates of deposit.....	<u>277,735</u>
	299,827
Short-term investments:	
U.S. Treasury obligations.....	100,000
Commercial paper.....	208,167
Short-term investment pool.....	394,821
Repurchase agreements.....	809,000
Money market investments	802,287
Total.....	<u>\$ 2,614,102</u>

Pooled cash and short-term investments include the following:

Cash & short-term investments.....	\$ 4,030,484
Cash with fiscal agent.....	24,823
Deficiency in cash and short-term investments.....	(1,441,205)
Total.....	<u>\$ 2,614,102</u>

The Pension Trust Funds have invested a significant portion of their portfolios into a pooled trust which accounts for their operations in a manner similar to a mutual fund. The pooled trust is permitted to invest in

equity securities, fixed income securities, real estate and other alternative investments.

In July 1996, the Governor signed into law Chapter 315 of the Acts of 1996. This law became effective November 7, 1996 and merged the two state pension funds - Massachusetts State Teachers and Employee Retirement Systems Trust (MASTERS) and the Pension Reserve Investment Trust (PRIT). The transfer of assets from MASTERS to PRIT occurred on January 1, 1997.

The investments are carried at fair value. At June 30, 1997, they are as follows (amounts in thousands):

	Amount
Investments:	
Equity securities.....	\$ 10,225,253
U.S. government and government agency securities....	2,802,405
Fixed income securities.....	1,352,409
Real estate.....	753,996
Alternative investments.....	785,704
International investments.....	3,609,005
Total.....	<u>\$ 19,528,772</u>

Financial Instruments with Off-Balance Sheet Risk -

Certain investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. A description of such "off-balance sheet risks" are as follows:

Forward Currency Contracts - The Pension Trust Funds enter into forward currency contracts to hedge the exposure to change in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates. Risks may arise upon entering these contracts from the potential inability of counterparts to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

When the contract is closed, the Pension Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. Fluctuations in the value of forward currency contracts are recorded as unrealized gains or losses by the Pension Trust Funds.

Future Contracts - The Pension Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owes or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or

securities equal to a percentage of the contract amount.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments which may correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its future positions due to a non-liquid secondary market. Risks may arise from the potential inability of a counterparty to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. The Pension Trust Funds may also invest in financial futures contracts for non-hedging purposes.

Payments are made or received by the Pension Trust Funds each day, depending on the daily fluctuations in the value of the underlying security and are recorded as unrealized gains or losses. When the contracts are closed, the Pension Trust Funds recognize a realized gain or loss.

Options - PRIT is also engaged in selling or "writing" options. The Pension Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bears the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 1997, there were no material options outstanding.

5. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Massachusetts General Laws authorize the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified among fund liabilities.

General Fund - The Commonwealth is authorized by Massachusetts General Laws to issue short-term notes to finance working capital advances to the MBTA. The Commonwealth retires these notes through subsequent appropriations and assessments to cities and towns. There were no such notes outstanding at June 30, 1997.

The balance of revenue anticipation notes (RANs) outstanding fluctuates during the fiscal year but must be reduced to zero at June 30. During fiscal year 1997, there were no RANs issued or outstanding.

Capital Projects Funds - The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects, but it must reduce the balance to

\$200,000,000 at June 30. During fiscal year 1997, there were no BANs issued or outstanding.

Section 9 of Chapter 11 of the Acts of 1997 authorized the Commonwealth to sell up to \$1,000,000,000 in Grant Anticipation Notes (GANS) in anticipation of receipt of federal funds related to Central Artery/Third Harbor Tunnel projects. During 1997 there were no GANS issued or outstanding.

Letter-of-Credit Agreements – During fiscal year 1997, the Commonwealth maintained letter-of-credit agreements with several banks in order to provide credit and liquidity support for its commercial paper program. The letters of credit were available to secure up to \$400,000,000 of Commonwealth commercial paper plus interest thereon. Advances were available, subject to certain limitations and bearing interest at the bank rate as defined, in anticipation of revenue or bond proceeds and repayable by the following June 30, subject to extension in certain circumstances, at the Commonwealth's option. No such advances were drawn during the fiscal year ended June 30, 1997, or subsequent thereto. These agreements expire October 31, 1997 through September 1, 1998. The average costs are approximately .07% on unutilized amounts and approximately .10% on utilized amounts.

Line-of-Credit Agreement – During fiscal year 1997, the Commonwealth maintained a line of credit with a bank to provide liquidity support for up to \$200,000,000 of commercial paper notes. The line of credit expires September 30, 1999. The average costs of all the lines of credit are approximately .06% on unutilized amounts and approximately .08% on utilized amounts.

6. LONG-TERM BONDS

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit by a two-thirds vote of the members of each house of the Legislature present and voting thereon, but such credit may not in any manner be given or loaned to or in aid of any individual, or of any private association, or of any corporation which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 1997, the Commonwealth had four types of bonds outstanding: general obligation, dedicated income tax, college opportunity, and special obligation. The general obligation bonds are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds, in which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

During fiscal year 1991, dedicated income tax bonds were issued as authorized by Chapter 151, Acts of 1990, to finance the combined net undesignated fund deficit in the General and Local Aid Funds at June 30, 1990. These bonds are designated Fiscal Recovery Loan, Act of 1990, and they are secured by the pledge of certain dedicated income tax revenues and the investment earnings thereon, as well as the full faith and credit of the Commonwealth.

The Commonwealth issues college opportunity bonds as authorized by the Massachusetts General Laws. These bonds are backed by the full faith and credit of the Commonwealth. At June 30, 1997, the Commonwealth has outstanding \$79,508,000 of such college opportunity bonds. Included in this amount is approximately \$34,598,000 of accreted interest.

The Commonwealth also issues special obligation revenue bonds as authorized by the Massachusetts General Laws. Such bonds may be secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 1997, the Commonwealth had outstanding \$520,760,000 of such special obligation bonds, secured by a pledge of 6.86 cents of the 21 cent motor fuel excise tax imposed on gasoline.

For financial reporting purposes, long-term bonds are carried at their face amount, which includes discount and any issuance costs financed. The outstanding amount represents the total principal to be repaid; for capital appreciation bonds, it represents total principal and interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of bonds authorized but unissued is measured in accordance with the statutory basis of accounting, with only the net proceeds (exclusive of discount and costs of issuance) deducted from the total authorized by the Legislature.

General obligation, dedicated income tax, college opportunity, and special obligation long-term bonds outstanding (including discount and issuance cost) and bonds authorized-unissued at June 30, 1997, are as follows (amounts in thousands):

<u>Purpose</u>	<u>Outstanding Amounts</u>	<u>Maturities</u>	<u>Authorized - Unissued</u>
Deficit Reduction:			
Fiscal Recovery.....	\$ 129,900	1997-1998	\$ 57,274
Capital Projects:			
General.....	4,996,155	1997-2025	4,912,029
Highway.....	3,668,189	1997-2016	6,143,163
Local Aid.....	1,414,517	1997-2015	699,855
Other.....	62,533	1997-2025	141,821
	<u>10,141,394</u>		<u>11,896,868</u>
Total.....	<u>\$ 10,271,294</u>		<u>\$ 11,954,142</u>

Interest rates on the Commonwealth's bonded debt outstanding at June 30, 1997 ranged from .10% to 14.13%.

Changes in long-term bonds outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 1997 are as follows (amounts in thousands):

	<u>Bonds Outstanding</u>	<u>Authorized - Unissued</u>
Balance July 1, 1996.....	\$ 10,065,578	\$ 8,182,843
General and Special obligation bonds:		
Principal less discount and issuance costs	899,471	(899,471)
Discount and issuance costs.....	33,843	
General obligation refunding bonds:		
Principal of bonds issued.....	722,621	
Refunded bonds.....	(697,550)	
Increase in bonds authorized.....		4,707,040
Bonds retired.....	(752,669)	
Expiration of authorizations.....		(36,270)
Balance June 30, 1997.....	<u>\$ 10,271,294</u>	<u>\$ 11,954,142</u>

At June 30, 1997, debt service requirements to maturity for principal (including discount, capital appreciation and issuance costs) and interest are as follows (amounts in thousands):

<u>Fiscal year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
1998.....	\$ 703,716	\$ 507,223	\$ 1,210,939
1999.....	635,187	469,489	1,104,676
2000.....	640,604	433,328	1,073,932
2001	658,470	401,017	1,059,487
2002	622,911	367,431	990,342
2002 and thereafter.....	<u>7,010,406</u>	<u>2,210,459</u>	<u>9,220,865</u>
Total.....	<u>\$ 10,271,294</u>	<u>\$ 4,388,947</u>	<u>\$ 14,660,241</u>

The Commonwealth issued bonds and notes under negotiated contracts and under competitive bidding contracts during fiscal year 1997. The costs for legal counsel and underwriting fees under competitive bond sale costs were estimated at \$152,000 and \$2,239,000, respectively. Negotiated legal fees and underwriter fees were estimated at \$97,000 and \$4,668,000 respectively.

Subsequent to June 30, 1997, the Commonwealth issued \$19,902,000 in college opportunity bonds with variable interest rates, \$250,000,000 in general obligation bonds with interest rates ranging from 5.00% to 5.75%, \$375,840,000 in general obligation refunding bonds with interest rates ranging from 4.5% to 5.75%, \$271,280,000 general obligation refunding bonds with variable interest rates and \$294,695,000 in special obligation bonds with interest rates ranging from 3.75% to 5.5%, which included \$191,080,000 in special obligation refunding bonds and \$103,615,000 in new issue special obligation bonds.

Advance Refunding and Defeased Bonds - As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general obligation and other bonds through the issuance of \$722,621,000 of general obligation refunding bonds during fiscal year 1997. Proceeds totaling approximately \$741,997,000, including bond premiums, were used to purchase U. S. Government securities which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from the General Long-term Obligations Account Group. As a result of these advance refundings, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately \$35,926,000 over the next 20 years and will experience

an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately \$30,074,000. At June 30, 1997, approximately \$665,955,000 of the bonds refunded remain outstanding and are considered defeased.

In prior years, the Commonwealth also defeased certain general obligation and other bonds by placing the proceeds of refunding bonds in irrevocable trusts to provide for all future debt service payments on the refunded bonds. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 1997, approximately \$2,701,874,000 of bonds outstanding from advance refundings in prior fiscal years are considered defeased.

Statutory Debt Limit –The Massachusetts General Laws establish limits on the amount of direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for fiscal year 1997 was \$9,112,650,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined to include general obligation bonds and minibonds at the amount of their original net proceeds. It excludes bond anticipation notes and discount and issuance costs, if any, financed by these bonds. It also excludes dedicated income tax bonds, special obligation bonds, refunded bonds, and certain refunding bonds.

The amounts excluded from the limited are as follows (amounts in thousands):

	<u>Bond Outstanding</u>
Balance June 30, 1997.....	\$ 10,271,294
Less amounts excluded	
Discount and issuance cost.....	(735,393)
Fiscal Recovery Principal.....	(126,470)
Chapter 5 of the Acts of 1992 Refunding.....	(144,509)
Special Obligation Principal.....	(512,589)
Outstanding Direct Debt.....	<u>\$ 8,752,333</u>

7. LEASES

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease/purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. These agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature. For the fiscal year ended June 30, 1997, lease/purchase expenditures under these agreements totaled approximately \$ 39,350,000. At June 30, 1997, the Commonwealth's aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totals \$131,375,000. This liability is reported in the General Long-Term Obligations Account Group. Equipment acquired under capital leases and included in the General Fixed Assets Account Group totaled approximately \$193,380,000.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature. Rental expenditure for the fiscal year ended June 30, 1997 was approximately \$123,442,000.

The following is a schedule of future minimum payments under non-cancelable leases as of June 30, 1997 (amounts in thousands):

Fiscal Year Ending June 30,	<u>Capital Leases</u>	<u>Operating Leases</u>
1998.....	\$ 38,446	\$103,776
1999.....	33,968	82,042
2000.....	25,680	60,113
2001.....	16,489	39,011
2002.....	11,610	27,914
2003 and thereafter.....	<u>29,715</u>	<u>13,594</u>
Total.....	155,908	326,450
Less interest.....	<u>(24,533)</u>	-
Present value	<u>\$ 131,375</u>	<u>\$326,450</u>

8. INDIVIDUAL FUND DEFICITS

Certain Budgeted, Non-Budgeted Special Revenue and Capital Projects Funds included in the combined totals have individual fund deficits at June 30, 1997, as follows (amounts in thousands):

Budgeted Funds:	
Local Aid.....	\$ 1,355,829
Mosquito and Greenhead Fly Control.....	742
Environmental Challenge.....	2,457
Toxic Use Reduction.....	1,807
Environmental Permitting and Compliance Assurance.....	17,326
Environmental Law Enforcement.....	896
Marine Fisheries.....	1,503
Low-Level Radio Active Waste Management....	178
Clean Air Act Compliance.....	527
Anti-trust Law Enforcement.....	1,393
Second Century.....	1,482
Victim and Witness Assistance.....	3,127
Intercity Bus Capital Assistance.....	7,055
Health Care Access.....	10,043
Leo J. Martin Recreation.....	132
	<u>1,404,497</u>
Non-Budgeted Special Revenue:	
Other:	
Government Land Bank.....	33,798
Motor Vehicle Emissions Inspection Compliance.....	2,654
Child Support Enforcement.....	37
	<u>36,489</u>
Capital Projects:	
General.....	132,680
Highway.....	156,562
Community Development Action Grants.....	67,472
Local Infrastructure.....	2,350
County Correctional Facilities.....	47
Water Pollution Control.....	1,111
State Recreation Areas.....	43
Metropolitan Parks.....	1,356
Intercity Bus Capital Assistance.....	18
	<u>361,639</u>
Total	<u>\$ 1,802,625</u>

In order to resolve the deficits in the budgeted funds, the Comptroller has recommended the authorization of transfers from other budgeted funds with surplus balances or a plan of fund consolidation. Once these changes are adopted by the legislature, the deficiency in the Local Aid Fund will be resolved. For the Non-Budgeted Special Revenue Funds, the Comptroller has recommended similar budgeted transfers to subsidize and resolve the deficits or their consolidation into budgeted funds. Such steps require legislative action.

In the Capital Project Funds, the deficit of \$361,639,000 reflects the time lag between capital expenditures and the

receipt or allocation of proceeds from the sale of related bonds. Subsequent to June 30, 1997, the Commonwealth issued \$19,902,000 in college opportunity bonds; \$250,000,000 in general obligation bonds, and \$103,615,000 in special obligation revenue bonds to finance the deficit.

9. MEDICAID COSTS

The Commonwealth provides medical care for low-income, elderly and other residents who qualify for such assistance under the federally-sponsored Medical Assistance Program (Medicaid). The Commonwealth pays the full cost of care and is reimbursed by the federal government for 50% of that cost. For the fiscal year ended June 30, 1997, the General Fund and Local Aid Funds include \$3,455,531,000 in expenditures for Medicaid claims processed for payment.

The combined financial statements – statutory basis include Medicaid claims processed but unpaid at June 30, 1997, as accounts payable of approximately \$84,433,000. In addition, the Commonwealth estimates its liability, as determined in accordance with generally accepted accounting principles, at \$568,921,000. This amount includes estimates of both the cost of care provided as of June 30, 1997, for which claims have not been processed, and the cost associated with nursing home and hospital rate settlements and other costs. Of this amount, 50% is expected to be reimbursed by the federal government.

10. RETIREMENT SYSTEMS

Primary Government – The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth).

The members of the retirement systems do not participate in the Social Security System. The Commonwealth has also assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, in fiscal year 1997 and prior fiscal years.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis.

Plan Descriptions –

State Employees' Retirement System (SERS) is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity; no stand alone financial report is issued.

Teachers' Retirement System (TRS) is an agent multiple employer defined benefit PERS with 104 participating employers. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS. The TRS covers certified teachers in cities (except the City of Boston), towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

State – Boston Retirement System (SBRS) is hybrid multiple employer defined benefit PERS. SBRS provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRS. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRS participants who serve in the City of Boston's School Department in a teaching capacity. The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRS is not administered by the Commonwealth, is not part of the reporting entity and a stand alone financial report is not available.

The Commonwealth has assumed financial responsibility for the COLA granted to participants in the 104 retirement systems of cities, towns and counties in fiscal year 1997 and prior fiscal years. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic

pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity.

The policy for postretirement benefit increases for all retirees of the SERS, TRS, SBRS and COLA are subject to legislative approval.

Membership – Membership in SERS, TRS and SBRS as of January 1, 1996 is as follows:

	<u>SERS</u>	<u>TRS</u>	<u>SBRS</u>
Retirees and beneficiaries			
currently receiving benefits.....	42,443	28,831	2,257
Terminated employees entitled to			
benefits but not yet receiving them..	1,706	1,607	602
Subtotal.....	44,149	30,438	2,859
Current employees:			
Vested.....	43,679	46,432	3,897
Non-vested.....	39,519	22,432	2,416
Subtotal.....	83,198	68,864	6,313
Total.....	127,347	99,302	9,172

Benefit Provisions – Massachusetts General Laws establish uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group classification. The authority for amending these provisions is with the legislature.

Retirement allowance consists of two parts: an annuity and a pension. A member's accumulated total deductions and a portion of interest they generate constitute the annuity. The differential between the total retirement benefit and the annuity is the pension. Average retirement benefit is approximately 80-85% pension and 15-20% annuity.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

Funding Progress - The SERS, TRS and SBRS actuarial determined contributions were computed as part of the actuarial valuation as of January 1, 1996. Significant actuarial assumptions used in the calculation of contribution requirements and net pension obligation

include (a) rates of return on investments of present and future assets of 8.5% per year, (b) projected salary increases of 6% per year, (c) cost of living (inflation rate) increases of 3% per year on the first \$9,000 of the retirees total allowance, (d) interest rate credited to the

annuity savings fund of 5.5% per year, (e) the use of the level dollar amortization method over 40 years closed period, and (f) actuarial value of assets is equal to fair value.

The following table presents the six year-year schedule of funding progress (amounts in thousands):

Actuarial Valuation as of January 1,	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Net Pension (Obligation) Asset (NPO)	Funded Ratio %	Annual Covered Payroll *	NPO as a % of Covered Payroll
State Employers Retirement System						
1996	\$ 7,366,000	\$ 6,595,676	\$ 770,324	112 %	\$ 2,989,000	25.8 %
1995	5,879,000	5,327,027	551,973	110	2,992,000	18.4
1994	5,802,000	5,429,773	372,227	107	3,094,000	12.0
1993	5,071,000	4,840,405	230,595	105	2,919,000	7.9
1992	4,699,000	4,629,763	69,237	101	2,638,000	2.6
1991	4,052,000	4,053,705	(1,705)	100	2,300,000	(0.1)
Teachers Retirement System						
1996	7,553,000	7,025,561	527,439	108	2,810,000	18.8
1995	6,014,000	5,657,399	356,601	106	2,667,000	13.4
1994	5,956,000	5,673,619	282,381	105	2,573,000	11.0
1993	5,142,000	4,942,309	199,691	104	2,428,000	8.2
1992	4,784,000	4,659,680	124,320	103	2,032,000	6.1
1991	4,086,000	4,023,551	62,449	102	2,065,000	3.0
State Boston Retirement System						
1996	549,000	524,510	24,490	105	274,000	8.9
1995	438,000	416,113	21,887	105	232,000	9.4
1994	443,000	421,635	21,365	105	218,000	9.8
1993	370,000	354,800	15,200	104	206,000	7.4
1992	342,000	333,871	8,129	102	184,000	4.4
1991	301,000	293,072	7,928	103	203,000	3.9

* - The covered payroll amounts approximate the employer payroll.

Contributions Required and Contributions Made – The retirement systems' funding policies have been established by Chapter 32 of the Massachusetts General Laws. The legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and SBRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation – 5% for those hired before January 1, 1975, 7% for those hired from January 1, 1975, through December 31, 1983, and 8% for those hired on or after January 1, 1984, plus an additional 2% of compensation above \$30,000 per year for those hired on or after January 1, 1979. Regular employees and state police hired after June 30, 1996 are required to contribute 9% and 12% respectively of their regular compensation plus

an additional 2% of compensation above \$30,000 per year. Costs of administering the plan are funded out of plan assets.

The Commonwealth's contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover SBRS and COLA contributions were originally established on a "pay-as-you-go" basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in SBRS and its COLA obligation. This legislation

requires funding on a current basis, including amortizing the unfunded liabilities and liabilities for future COLA payments to local systems, over 40 years.

This legislation also directs the Secretary for Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary's direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be made in accordance with the most recently approved schedule. This legislation further provides that if, during the first ten years of scheduled payments, the pension benefits paid exceed the scheduled contribution, the Commonwealth's contribution shall equal these benefit payments.

The current legislatively approved funding schedule,

based on the January 1, 1993 valuation, was filed with the Legislature on October 26, 1994. It required contributions by the Commonwealth of \$965,903,000 during the fiscal year ended June 30, 1997. Because total benefit payments out of the budgeted funds exceeded this amount, no additional Commonwealth contribution is required.

GAAP requires that pension expenditures (costs) be based on an acceptable actuarial cost method and that they be not less than:

- Normal cost and amortization cost
- Interest and amortization on any unfunded prior service costs

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1,	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution made	Net Pension (Obligation) Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
State Employers Retirement System								
1996	\$ 232,158	\$ (46,918)	\$ 29,523	\$ 214,763	\$ 433,114	\$ 770,324	187 %	202 %
1995	249,640	(31,639)	19,614	237,615	417,361	551,973	167	176
1994	266,564	(18,448)	9,152	257,268	398,900	372,227	150	155
1993	243,587	(5,539)	2,694	240,742	402,100	230,595	165	167
1992	252,687	136	(65)	252,758	323,700	69,237	128	128
1991	282,682	2,335	(1,094)	283,923	311,400	(1,705)	110	110
1990	259,102	4,569	(2,103)	261,568	289,500	(29,182)	112	111
1989	298,800	2,160	(977)	299,983	269,866	(57,114)	90	90
1988	279,582	-	-	279,582	252,585	(26,997)	90	90
Teachers Retirement System								
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
1995	277,343	(24,002)	14,880	268,221	342,441	356,601	123	128
1994	247,460	(15,975)	7,925	239,410	322,100	282,381	130	135
1993	225,838	(9,946)	4,837	220,729	296,100	199,691	131	134
1992	223,041	(4,996)	2,384	220,429	282,300	124,320	127	128
1991	249,436	(3,452)	1,617	247,601	266,900	62,449	107	108
1990	227,270	(1,459)	671	226,482	251,400	43,150	111	111
1989	249,108	(1,595)	722	248,235	246,531	18,232	99	99
1988	232,661	-	-	232,661	252,597	19,936	109	109
State Boston Retirement System								
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108
1995	28,168	(1,816)	1,126	27,478	28,000	21,887	99	102
1994	22,448	(1,216)	603	21,835	28,000	21,365	125	128
1993	20,463	(650)	316	20,129	27,200	15,200	133	135
1992	26,530	(634)	303	26,199	26,400	8,129	100	101
1991	23,149	(413)	193	22,929	25,700	7,928	111	112
1990	21,118	(251)	116	20,983	23,000	5,157	109	110
1989	21,744	(127)	58	21,675	23,225	3,140	107	107
1988	20,315	-	-	20,315	21,905	1,590	108	108

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

During the year ended June 30, 1997, the Commonwealth's pension expenditure included payments totaling \$19,005,000 to current retirees employed prior to the establishment of the current plans and to non-contributory plans.

Post-retirement Health Care and Life Insurance Benefits – In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs which is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of providing these benefits when paid. These payments totaled approximately \$153,538,000 for the fiscal year ended June 30, 1997. There are approximately 44,000 participants eligible to receive benefits at June 30, 1997.

11. COMMITMENTS

Under Chapters 161A and 161B of the General Laws, the Commonwealth is obligated to provide annual subsidies to the MBTA and certain regional transit authorities for contract assistance, debt service assistance and their net cost of service deficiencies. The Commonwealth recovers a portion of these payments through assessments to the cities and towns served. During fiscal year 1997, net expenditures were \$483,142,000 and \$37,722,000, respectively. For fiscal year 1998, the Commonwealth has appropriated \$501,398,000 and \$38,070,000 to the MBTA and regional transit authorities, respectively. These appropriations cover net costs of service for the calendar year ended December 31, 1996.

The Commonwealth is also statutorily obligated to provide contract assistance for debt service obligations to the Massachusetts Convention Center Authority

(MCCA) and the Government Land Bank. Such assistance totaled \$30,643,000 in fiscal year 1997. For fiscal year 1998, appropriations for this purpose totaled \$30,660,000.

At June 30, 1997, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support totaled approximately \$3,267,697,000 long-term and \$393,375,000 short-term. In addition, the Commonwealth guarantees the debt of certain local governments and public higher education building authorities. The guaranteed long-term debt outstanding at June 30, 1997 was approximately \$237,012,000.

At June 30, 1997, the Commonwealth had commitments of approximately \$3,089,493,000 for various construction projects. The majority relate to construction funding for a major infrastructure project known as the Central Artery Project, in which continued federal participation is anticipated. In addition, the Massachusetts Turnpike Authority and The Massachusetts Port Authority are obligated to provide a minimum of \$700 million and \$200 million respectively to finance portions of the Central Artery/Tunnel project. The remainder relates to a wide range of building construction projects.

12. CONTINGENCIES

A number of lawsuits are pending or threatened against the Commonwealth which arose from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For those cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately \$66,700,000 which is expected to be paid in fiscal year 1998. No accrual has been made for this amount in the combined financial statements – statutory basis.

Workers' compensation costs are recognized when claims are presented and paid. The Commonwealth's outstanding liability for such claims at June 30, 1997, is estimated to be \$286,600,000, of which approximately \$35,400,000 is expected to be paid during fiscal year 1998. No accrual has been made for these amounts in the combined financial statements – statutory basis.

The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally conditional upon compliance with terms and conditions of the grant or reimbursement

agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund which received the assistance. At June 30, 1997, the Commonwealth estimated that liabilities, if any, which may result from such audits are not material.

Chapter 200A of the Massachusetts General Laws, the Commonwealth's Abandoned Property Law, requires deposit of certain unclaimed assets into a managed Fiduciary Fund. These unclaimed assets, less \$9,210,000, which is expected to be reclaimed and paid in fiscal year 1998, are to be remitted to the General Fund each June 30, where it is included as miscellaneous revenue. Amounts remitted during fiscal year 1997 totaled approximately \$64,884,000. Since inception, approximately \$681,056,000 has been remitted. This represents a contingency, because claims for refunds can be made by the owners of the property.

13. NON-TAX REVENUE INITIATIVES

Chapter 653, Acts of 1989, amended Chapter 29 of the Massachusetts General Laws by adding Sections 29D and 29E, which authorize certain non-tax revenue initiatives and require reporting thereon, as follows.

Debt Collection – Private debt collectors were engaged, with fees, on a contingent basis, from the proceeds collected. Collections and fees paid during fiscal year 1997 were:

<u>Department Collectors</u>	<u>Collections</u>	<u>Fees</u>
Allen Daniel Associates.....	\$ 217,323	\$ 79,516
Glenn Associates.....	26,078	52,652
Gragil Associates.....	55,370	11,318
Payco.....	34,858	7,485
Walker.....	136,962	16,451
Windham Professionals.....	<u>335,453</u>	<u>56,559</u>
Total.....	<u>\$ 806,044</u>	<u>\$ 223,981</u>

No amounts were collected and no fees were paid to Capital Credit Corporation.

Under a similar program for the Commonwealth's public institutions of higher education, the following amounts were collected and fees paid:

<u>Department Collectors</u>	<u>Collectors</u>	<u>Fees</u>
Allen Daniel Associates.....	\$ 526,580	\$ 109,027
Associated Credit Services....	13,303	2,602
Collection Co. of America.....	2,485,347	734,301
Financial Coll Agency.....	36,369	4,987
Glenn Associates.....	283,877	8,569
Gragil Associates.....	15	4
Payco.....	936,175	225,320
Walker Associates.....	3,970	843
Windham Professionals.....	<u>288,902</u>	<u>102,197</u>
Total.....	<u>\$4,574,538</u>	<u>\$1,187,850</u>

Revenue Maximization – Contractors were engaged on a contingent fee basis to assist several of the Commonwealth's departments in the identification and collection of federal and other revenues. During fiscal year 1997, approximately \$101,896,000 was collected through such efforts. After contractor fees were paid on a contingent basis, the Commonwealth received approximately \$90,176,000.

Pursuant to Section 608 of Chapter 151 of the Acts of 1996 (the FY97 budget), the Comptroller's Office is authorized to engage vendors for the purpose of identification and pursuit of cost savings/avoidance opportunities. Currently there is one department engaged in a Section 608 procurement/project, but no cost avoidance was recognized in FY97.

Utility Audits – Massachusetts General Law, Chapter 20 Section 29G, authorizes the Department of Procurement and General Services to solicit services and enter into contingent contracts on behalf of governmental entities for the potential of recoupment of overcharges associated with utility expenses. During fiscal year 1997, \$481,000 was recouped and \$202,000 was paid to the Utility Management Group, resulting in a net benefit to the Commonwealth of \$279,000. As of June 30, 1997, reviews were in process for 52 municipalities who have taken advantage of the master service agreement negotiated by Procurement and General Services.

14. CHANGE IN REPORTING

Legislation enacted as part of Chapter 88 Acts of 1997 amended Section 12 of Chapter 7A of the General Laws to streamline year end accounting and financial reporting. One change was to eliminate the Preliminary Financial Report previously published on September 15th; and to publish the audited Statutory Basis Financial Report on October 31st (the prior publication date was December 31st). The other change was to remove the

Non-Appropriated activity of Higher Education from the combined financial statements - statutory basis. These changes have been implemented for the fiscal year ended June 30, 1997. There is no effect of the change in reporting entity on the aggregate beginning fund equity in the governmental fund types.

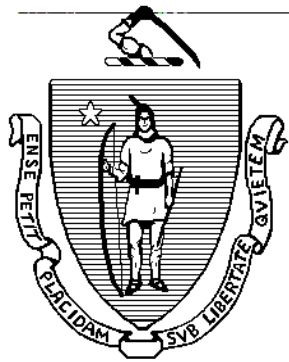
15. SUBSEQUENT EVENTS

Subsequent to year end, legislation was enacted to abolish four counties:

Franklin County - Section 567 of Chapter 151 of the Acts of 1997, abolished Franklin County as of July 1, 1997 and transferred its functions, assets, debts and obligations to the Commonwealth.

Middlesex County - Chapter 48 of the Acts of 1997 abolished the Middlesex County as of July 11, 1997 and transferred its functions, assets, debts and obligations to the Commonwealth.

In addition, Chapter 48 called for the preparation of a similar abolition of Hampden and Worcester Counties as of July 1, 1998 or earlier if the county fails to make a required payment on an outstanding bond or note. Commencing in fiscal year 1998 the Commonwealth will include in its audited financial statements the financial activity of the abolished counties; for fiscal years 1997 and prior periods, the responsibility for audited financial statements reside with the former county entity.



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